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SMALL AND MEDIUM-SCALE ENTERPRISES IN NIGERIA:

Their characteristics, problems and sources of finance

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I Introduction

Until the early 1960s, many economists viewed the continued existence of small-scale industries in less developed countries as justified by scarcity of capital and administrative experience. It was often argued that with economic growth, the small, traditional type of enterprise would, in one sector after another, be superseded by modern forms of large-scale production. In order to ensure an orderly transition, small industries were seen to deserve support, but mainly in sectors where modern methods could not be immediately applied.

In the mid-1960s a new approach to small to medium-scale enterprise (SME) development began to emerge due to a number of factors. First, there was growing concern over low employment elasticity of modern, large-scale production. It was claimed that even with more optimal policies, this form of industrial organization was unable to absorb a significant proportion of the rapidly expanding labour force (Chenery *et al.*, 1974; ILO, 1973). Second, there was widespread recognition that the benefits of economic growth were not being fairly distributed, and that the use of large-scale, capital-intensive techniques was partly to blame (Chenery *et al.*, 1974). Third, empirical diagnosis showed that the causes of poverty were not confined to unemployment, and that most of the poor were employed in a large variety of small-scale, low-productivity activities. Thus, it was thought that one way to alleviate poverty could be to increase the productivity of those engaged in small-scale production (Aftab and Rahim, 1989).

This suggested a new role for small industries, or what has come to be labelled "the urban informal sector". Small, labour-intensive industries were seen not only to increase employment, but also to increase the living standards of the poor. They were also thought to be capable of providing a new dynamic of economic growth. The new objective was not just to stop the retreat, but to promote the small-scale sector (Schmitz, 1982; Aftab and Rahim, 1989).

This change in approach was accompanied by a shift of focus towards a "rurally orientated smallholder" (ROSH) industrialization strategy, well articulated in Oshima (1962), UNDP (1974), Kilby (1975), Acharya (1981), Daniel *et al.* (1985), and Olofin (1990), among others.

While the World Bank (1989) and others have tended to favour the ROSH implementation strategy by assigning the major role to the private sector, there are those who favour its implementation by assigning a major role to government (Olofin, 1990). Assigning the major role to the private sector has its appeal in the fact that the private sector has the resources needed to implement the strategy. But the proponents of assigning the role to the government are aware that in many developing economies, government is the major mover of the economy with only a small and sometimes weak private sector. Thus, they argue that assigning such an important role to the private sector would not work. Besides, for the strategy to produce an optimal effect on the well-being of the people, the social environment has to be considered — something the private sector may not be willing to do.

Kilby (1969) sees SMEs as a *quasi* sponge for urban employment and a provider of inexpensive consumer goods with little or no import content, serving an important pressure-releasing and welfare-augmenting function. SMEs also contribute to long-run industrial growth by producing an increasing number of firms that grow up and out of the small-scale sector. The emergence of wholly modern small/medium-scale Nigerian industries is likely to be a prerequisite for any enduring industrialization.

However, despite government efforts in Nigeria to promote SMEs, not much progress seems to have been achieved, judging by SME performance. This study examines survey data in order to evaluate the characteristics of SMEs that make it more difficult for them to be profitable and the particular problems that they face which may have contributed to their poor performance.

Objectives of the study

In order to examine these issues, the following research questions have been raised:

1. what are the characteristics of the SMEs with reference to the educational background of the operators, their training and experience before embarking on the business, the type of business they operate, and the size of the enterprise?

2. what are their sources of funds (formal or informal institutions)?

3. is there any relationship between the two markets as shown in the service they provide, e.g. are these two markets complementary, competitive, dualistic, or is one a substitute for the other?

4. how have government policies affected the development of SMEs and their sources of funds?

II Characteristics of SMEs in Nigeria

Defining SMEs

There is no generally accepted definition of a small business because the classification of businesses into large-scale or small-scale is a subjective and qualitative judgement. In countries such as the USA, Britain, and Canada, small-scale business is defined in terms of annual turnover and the number of paid employees. In Britain, small-scale business is defined as that industry with an annual turnover of 2 million pounds or less with fewer than 200 paid employees.

In Japan, small-scale industry is defined according to the type of industry, paid-up capital and number of paid employees. Consequently, small and medium-scale enterprises are defined as: those in manufacturing with 100 million yen paid-up capital and 300 employees, those in wholesale trade with 30 million yen paid-up capital and 100 employees, and those in the retail and service trades with 10 million yen paid-up capital and 50 employees.

In Nigeria, there is no clear-cut definition that distinguishes a purely small-scale enterprise from a medium-scale enterprise. The Central Bank of Nigeria, in its Monetary Policy Circular No. 22 of 1988, defined small-scale enterprises as having an annual turnover not exceeding 500,000 naira. In the 1990 budget, the federal government of Nigeria defined small-scale enterprises for purposes of commercial bank loans as those with an annual turnover not exceeding 500,000 naira, and for Merchant Bank Loans, those enterprises with capital investments not exceeding 2 million naira (excluding cost of land) or a maximum of 5 million naira. The National Economic Reconstruction Fund (NERFUND) put the ceiling for small-scale industries at 10 million naira.

Section 37b(2) of the Companies and Allied Matters Decree of 1990 defines a small company as one with:

(a) an annual turnover of not more than 2 million naira;
(b) net asset value of not more than 1 million naira.

For the purposes of this study, small and medium-scale enterprises are defined as those with investments in machinery and equipment not exceeding 500,000 naira and 2 million naira, respectively, with not more than 50 and 100 paid employees, respectively. This definition does not reflect the characteristics of typical Nigerian small-scale enterprises in terms of their capital base and number of employees. The definition may at best relate to medium-scale enterprises. Small-scale enterprises in Nigeria require a separate definition.

Methodology

The study used the questionnaire/interview approach. Because of the absence of a sampling frame, the focus was by type of business, categorized as:

- one-man business
- partnership
- co-operative
- family business
- private limited company
- public limited company.

Through a purposeful sampling in both Lagos and Oyo States of Nigeria, 150 enterprises engaged in the six related types of business operations were selected. Of these, 80 were based in Lagos State, while 70 were based in Oyo State.

Survey execution

The major problem encountered was identifying the relevant enterprises and those that faced complete failure at the time of the survey. There was also the usual hesitation to complete questionnaires or respond to questions during interviews as many of the respondents took us for government officials or agents. People were also reluctant to talk about lending and borrowing.

Because of these problems, it was decided that a one-time interview would not provide the best research instrument. Instead, repeated visits to the enterprises were used to ensure that relevant and useful data were obtained. The data, which are considered reasonably reliable, were obtained only after much patience, prodding, visits and assurance that any information provided would be used for research purposes only and would be treated in confidence.

The interview process took nine weeks (July-September 1990), of which two weeks were spent in locating the enterprises and seven weeks in the interviews and administration of the questionnaires.

A major limitation of the study, which has affected the analysis of some of the results, was the failure to identify the exact time when those enterprises that failed actually went out of business.

Characteristics of SMEs based on study findings

In line with one of the objectives of the study, information was sought with respect to certain characteristics of the SMEs (and their operators), including the educational background of the operators, their training and experience before embarking on the project, the type of business they operate, and the size of the enterprise.

Educational background

All the respondents were asked questions related to their educational background (Table 1) and previous experience (Table 2). Later, the enterprises that failed completely (10 of them) were singled out to test in what respect they were different from the rest (see Table 3).

Table 1 Educational background of SME operators

Level of education	Frequency	Percentage
Primary	73	49
Secondary	53	35
Tertiary		
University	18	12
Polytechnic	6	4
Total	150	100

Source: Researchers' Survey Findings, 1990.

The results show that few of the respondents had tertiary education (16 per cent) while the majority had primary and secondary education (84 per cent). Results in Table 3 show that operators of 8 out of the 10 (about 80 per cent) enterprises that failed had secondary education, with only one having gone through the polytechnic. Both Tables 1 and 3 show that most of the operators of the enterprises that failed and those that did not fail had primary and secondary education.

Previous work experience

The study further sought to establish the level of experience of the operators of the enterprises prior to commencing the current business. Table 2 shows that many of the respondents had no previous experience in business before embarking on their current business activity. Most of them had a maximum of 5 years' experience with only 5 per cent having had more than 15 years' experience.

Table 2 Experience prior to commencing current business

Years of experience	Frequency	Percentage
0 years	41	28
1-5 years	79	53
6-15 years	22	14
Over 15 years	8	5
Total	150	100

Source: Researchers' Survey Findings, 1990.

The results in Table 3 show that 6 out of the 10 enterprises (60 per cent) that failed had no previous experience, 3 (30 per cent) had 0-5 years experience, and only 1 (10 per cent) had 5-15 years of experience. This indicates a strong correlation between lack of experience and business failure.

Table 3 Features of respondent companies which failed

Type of business	Ownership	Educational level of owners-managers	Work experience before entering business (years)	Reason for failure
Import and export	Private ltd company	Secondary	0	Banning of goods importation
Hotel	a. One man business	Secondary	0-5	Reduced patronage and inaccessibility to finance because of stringent credit policies and high interest rates
	b. Private ltd company	Secondary	0	
Supermarket	One man business	Secondary	0	Banning of goods importation
Motor dealer	Private ltd company	Secondary	5-15	Banning of car importation
Clearing and forwarding	a. Private ltd company	Secondary	0	Banning of importation of many items
	b. Private ltd company	Secondary	0	
Electronic stores	One-man business	Secondary	0	Banning of electronics importation and lack of finance due to high interest rate and stringent credit policy

Table 3 cont ...

Type of business	Ownership	Educational level of owners-managers	Work experience before entering business (years)	Reason for failure
Road construction	Private ltd company	Secondary	0-5	Embargo on award of new contracts by government
Fast food	Private ltd company	Polytechnic	0-5	Inaccessibility to finance, and demolition of illegal structures

Source: Researchers' Survey Findings, 1990.

Type of business

Failure was related more to the service-orientated type of businesses which also depended largely on imported components. They included those engaged in import and export, clearing and forwarding, motor dealership, electronics, and road construction. At various times before the liberalization of the economy, the government instituted several restrictive measures that worked against import-dependent enterprises.

Ownership structure

Table 4 shows that most of the companies were engaged in service-related activities with most of the ownership structure being sole proprietorship and partnership. Table 3 further shows that the failed enterprises were either a one-man business or a private limited liability company.

Capital base

The amount of money needed for business operations can directly influence the sources which the investor will approach. Some have argued that small enterprises with a small capital base would tend to use the informal financial institutions. As Table 4 shows, about 66 per cent of the enterprises covered in the study had a capital base of less than 100,000 naira, and about 34 per cent had a capital base of between 100,000 and 2 million naira.

Table 4 Relationship between capital base, number of employees, financing sources and type of business

Types of business	Companies (no.)	Employees (no.)	Capital base (naira)	Structure	Sources
Food and beverages	6	1-20	<100,000	Partnership	PS, CB
	2	21-50	100,000 < X < 2m	Partnership	MB, R, F
Brick-making	8	1-20	<100,000	Partnership	PS, ML, R, CS
Road-side mechanics	10	1-20	<100,000	Partnership	PS, R, E, F, ML
Printing	8	1-20	100,000 < X < 2m	Partnership	PS, R, CB, ML
	2	1-20	<100,000	Partnership	F
Fast food	8	1-20	<100,000	Partnership	PS, F, R
	2	21-50	100,000 < X < 2m	Partnership	CB, E
Electronic stores	2	1-20	100,000 < X < 2m	Sole proprietorship and partnership	PS, R, F
Road construction	2	21-100	100,000 < X < 2m	Partnership	PS, CB, MB
Import and export	2	1-30	100,000 < X < 2m	Private ltd liability and partnership	PS, CB
Supermarket	2	5-30	100,000 < X < 2m	Private ltd liability and partnership	PS, CS
Motor dealer	2	4-20	100,000 < X < 2m	Private ltd liability and partnership	PS, CB
Medicine and pharmacy	4	21-50	100,000 < X < 2m	Partnership	PS, R, CB
		1-20	<100,000	Partnership	F, MB
Clearing and forwarding	4	1-20	<100,000	Private Ltd company and sole proprietorship	PS, F
Carpentry	8	1-20	<100,000	Sole proprietorship	PS, F, E, R, CS
Plumbing	8	1-20	<100,000	Sole proprietorship	PS, R, CS, CB

Table 4 cont ...

Types of business	Companies (no.)	Employees (no.)	Capital base (naira)	Structure	Sources
Weaving	10	1-20	<100,000	Sole proprietorship	PS, R, ML, CS, E
Baking	6	1-20	<100,000	Sole proprietorship	PS, R, CB, F, CB, PS
	.4	21-50	100,000 < X < 2m	and partnership	R, ML
Welding	8	1-20	<100,000	Sole proprietorship	PS, R, E, F, ML
Shoe-making	10	1-20	<100,000	Sole proprietorship	PS, R, E, CS, F, ML
Tailoring	8	21-50	100,000 < X < 2m	Sole proprietorship	PS, CB, R
	2	1-20	<100,000	Sole proprietorship	MB, E, ML, F, PS
Pottery	4	1-20	<100,000	Sole proprietorship	PS
Hotel management	10	50-100	100,000 < X < 2m	Sole proprietorship	PS, CB
	4	21-50	<100,000	Sole proprietorship	PS, R, F
	2	1-20	<100,000	Private ltd liability	PS, MB

Notes:

PS	Personal savings
CB	Commercial banks
MB	Merchant banks
F	Friends
R	Relatives
E	*Esusu*
CS	Co-operative Societies
ML	Money lenders

III Problems of SMEs

General problems

Problems associated with SMEs and reasons for their failure have been widely identified. Some of these include: lack of planning, inimical government rules and regulations, poor marketing strategy, lack of technical know-how, and higher interest rates (Aftab and Rahim, 1989; Ekpenyong, 1983; Akamiokor, 1983).

Entrepreneurial deficiencies often pose more problems than is usually appreciated. The underlying attitudes and dispositions of entrepreneurs, which have deep roots in the traditional socio-cultural system, can seriously impede development of the entrepreneurial characteristics necessary for good performance of Nigerian SMEs. The availability of and accessibility to credit is also crucial to the effectiveness of SMEs in Nigeria. For local people to generate income from productive activities requires credit, especially to stimulate traditional heavily under-capitalized local enterprises. Availability of credit, more than any other service, awakens the aspirations of potential entrepreneurs.

Government policies seem to have constituted a serious problem area for SMEs. The beginning of harsh government policies toward SMEs can be traced back to 1982 with the introduction of "stabilization measures" which resulted in import controls and drastic budget cuts. These, in turn, adversely affected the subvention to the financial institutions established to provide financial assistance to the SMEs. For example, in 1983, out of a total of 8,380 applications for loans received from the SMEs for a total of 559.13 million naira, only 18 per cent (1,470 projects) for a total of 46.66 million naira was disbursed.

As the economic situation deteriorated, the government introduced the Structural Adjustment Programme (SAP) in 1986. Since the strategy of liberalization and deregulation of interest rates was implemented, interest rates have continued to increase. The SMEs, which prior to the SAP had been granted concessionary rates of interest (particularly for agricultural and housing loans), have had great difficulties obtaining credit.

The frequent changes, and sometimes conflicting government monetary policies, have also tended to hurt the SMEs. For example, while the government increased total credit allocation to SMEs from 16 to 20 per cent, the same government removed excess liquidity in the banking industry through increases in the minimum rediscount rate (MRR), transfer of government and parastatal accounts to the Central Bank and the creation of a Stabilization Securities Account (SSA) whereby the banks were debited with excess liquidity in their accounts with the Central Bank.

However, there is a growing awareness that industrialization in developing countries can be better achieved through the ROSH strategy, and Nigeria is currently focusing its attention in this direction. In 1986, the federal government established certain guidelines for the development of SMEs which included:

- establishing more industrial development centres (IDCs);
- establishing model industrial estates to encourage prospective small-scale industrialists;
- exploiting to the fullest existing World Bank-assisted programmes for the small-scale enterprises;
- introducing the "Work-For-Yourself" programme — a drive towards self-employment;
- introducing SME-related programmes, such as the Small-Scale Industries Scheme; the National Economic Reconstruction Fund; and the Small and Medium-Scale Enterprises Loan Scheme.

Problems determined from the survey results

The study went further to identify the problems associated with the operations of the SMEs that were surveyed. The aspects covered in the survey included: government regulations, finance, lack of education and experience, type of ownership, type of business, level of capitalization and ability to prepare feasibility reports.

Government regulations

Reactions by the respondents to government policies as a problem can be deduced from Table 3. All the enterprises that failed blamed their failure on one government policy or another.

Educational background

As Tables 1 and 3 indicate, the majority of the operators had primary and secondary education. The results in both tables did not provide a basis for a definite conclusion as to whether low level of education affected performance negatively. When the level of awareness of government policies was tested, the result showed that generally the respondents were not aware of the existence of the various incentives and credit facilities provided by government (see Table 5). While no conclusive pattern could be established, Table 5 shows that most of those who were not aware of the incentives and credit facilities had only primary education. This implies that low education level can negatively affect a manager's performance.

Previous experience

Table 2 shows that most of the respondents had only 1-5 years of experience prior to commencing their current businesses. When those enterprises that failed completely were analyzed, as many as 75 per cent of the respondents had no previous experience. It can safely be concluded that lack of experience coupled with low level of education can constitute problems for SMEs.

Type of business and ownership structure

As Tables 3 and 4 show, most of the enterprises surveyed were engaged in service-related activities and were either a one-man business or a private limited liability company. All of the companies that failed fell into these two categories. Most of them had resorted to the informal financial institutions for credit. The implication here is that a one-man privately-run enterprise is more prone to failure for the following possible reasons:

- the operator lacked appropriate skills and expertise as many of the sampled population had limited years of previous management experience and still more had no experience at all;

- the one-man type of enterprise encountered several problems, including lack of trained personnel, and would not be able to compete in a free market economy;

Table 5 Respondents' level of awareness of government credit facilities

Type of credit facility		Level of awareness Aware	Unaware
Nigerian Bank for Commerce and Industry		75	75
Respondents' level of education			
Primary		22	52
Secondary		38	19
Tertiary:	University	11	2
	Polytechnic	4	2
Nigerian Industrial Development Bank		89	61
Respondents' level of education			
Primary		28	41
Secondary		49	6
Tertiary:	University	8	10
	Polytechnic	4	4
Small-Scale Industries Credit Scheme		32	118
Respondents' level of education			
Primary		8	77
Secondary		10	39
Tertiary:	University	12	
	Polytechnic	2	2
SMEs Loan Scheme		28	122
Respondents' level of education			
Primary		4	75
Secondary		10	43
Tertiary:	University	10	4
	Polytechnic	4	-
NERFUND		45	105
Respondents' level of education			
Primary		10	71
Secondary		25	28
Tertiary:	University	8	4
	Polytechnic	2	2
Work-for-Yourself programme		38	112
Respondents' level of education			
Primary		10	70
Secondary		16	38
Tertiary:	University	8	4
	Polytechnic	4	-

Source: Researchers' Survey Findings, 1990.

- such enterprises would have difficulty gaining access to the formal financial institutions for credit but would be a good customer of the informal financial institutions.

Capital base

Table 4 shows that most of the enterprises had a capital base of less than 100,000 naira. As the amount of money needed for business operators can directly influence the sources which the investor will approach for credit, small enterprises with a small capital base would tend to use the informal financial institutions as their sources of financing. Table 4 shows that all the enterprises with a capital base of less than 100,000 naira turned more to the informal financial institutions for their financing than to the formal institutions.

Feasibility study

None of the respondents in this study had prepared a feasibility study before embarking on their projects. Instead, they relied on their past experience in business (which many of them did not have) and on the fact that others in the same line of business before them were successful without going through the intricacies of a feasibility report.

Although findings in this study are not conclusive, it is widely accepted that failure to carry out a feasibility study before embarking upon a project can pose serious problems to the operators. Besides, no serious lender in Nigeria would lend to an investor without evidence that the project is bankable.

IV Sources of finance

Potential sources of finance

There is wide consensus in Nigeria that government policies are made in favour of the formal sector and against the informal sector. This unfavourable situation weighs heavily on the SMEs. While formal sector enterprises enjoy such direct benefits as access to credit and foreign technology, restriction on competition through tariffs and quotas, and trade licensing, the informal sector is often ignored and even harassed by the authorities. Enterprises and individuals within this sector operate largely outside the system of government benefits and regulations and thus have no access to the formal credit institutions and the main sources of technology transfer.

Many of the economic agents within this sector operate illegally, often pursuing similar economic activities to those in the formal sector, such as marketing foodstuffs and consumer goods, repair and maintenance of machinery and consumer durables, and running transport services. Illegality in this case is generally not due to the nature of the economic activity but to an official limitation of access to legitimate activity (ILO, 1973). These official limitations sometimes include requiring enterprises to register their businesses and pay high registration fees; file certain statements of accounts; provide information about their activities (which the enterprises may consider to be confidential); and pay taxes, etc. These conditions have tended to limit not only the activities of SMEs but also their sources of financing.

There are three main sources of enterprise financing open to SMEs in Nigeria:

- *formal financial institutions* such as commercial banks, merchant banks, savings banks, insurance companies, and development banks;

- *informal financial institutions* consisting of money lenders, landlords, credit and savings associations (co-operative societies); esusu,[1] friends and relations;

- personal savings.

The majority of SMEs in Nigeria, having been harassed or merely tolerated by government and scorned by the formal financial institutions with respect to access to credit, have resorted to alternative sources of financing among the informal financial institutions. According to a study by Leonard (1977) on sources of agricultural credit and finance in West Kwara State of Nigeria, about 82 per cent of farmers sampled obtained credit from non-institutional sources (of which 58 per cent from friends and relatives, and 24 per cent from money lenders).

A study by Ojo (1984) on the courses of investment finance for small industries shows a similar trend (Table 6). Table 6 shows that almost all the funds came from personal savings (96.4 per cent) with about 3 per cent from the informal sector and 0.21 per cent from the formal financial institutions.

The trend is further established by a 1983/84 study by the Nigerian Institute for Social and Economic Research (NISER) (Table 7). Table 7 shows that about 73 per cent of the respondents obtained their funds from personal savings while only about 2 per cent obtained their funds from the formal financial institutions.

Sources of finance based on survey

Having discussed the potential sources of finance generally, the study sought to determine the sources of finance used by the specific enterprises covered in the study. Tables 8-11 show the results. Table 8 shows that about 10 per cent of the funds generated for the initial investment came from informal institutions. The bulk of the funds came from personal savings and the formal institutions. The pattern changed when those enterprises sought additional capital as shown in Table 9.

Table 9 shows a significant shift from personal savings and banks to the informal financial institutions. There were certain specific departures from the initial situation:

- the percentage of dependence on the informal financial institutions increased from about 10 per cent to about 56 per cent;

- the type of formal institution also changed, for example, no additional funds were sought from the merchant banks;

- fewer enterprises turned to the commercial banks.

Table 6 Sources of investment finance for small industries in Nigeria

Source of finance	Former Western State	Bendel State (respondents)	Kwara State	Lagos State	Total responses	Percentage
Owners' savings	13,273	2,709	1,023	4,156	26,161	96.4
Assisted by:						
Banks	22	10	1	14	47	0.21
Government institutions	1	-	5	3	9	0.04
Local authorities	-	7	-	-	7	0.03
Co-operative societies	4	8	-	1	13	0.06
Relatives and friends	25	322	3	61	640	2.92
Money lenders	38	27	-	7	72	0.33
Total	13,592	3,083	1,032	4,242	21,949	100.00

Source: Ojo (1976, 1984).

Table 7 Percentage distribution of industry group by sources of capital

Industry categories	Sources of capital							
	Private Nigerian	Private non-Nigerian	State government	Personal savings	Co-operative societies	Commercial and development banks	Local authorities	Total
Non-durable consumer goods	7.76	0.40	0.78	41.64	0.85	0.89	0.08	52.40
Durable consumer goods	6.17	0.04	1.90	14.01	0.23	0.70	0.08	23.13
Capital goods	6.28	0.15	0.23	17.27	0.31	0.23		24.47
Total	20.21	0.59	2.91	72.92	1.39	1.82	0.16	100.00

Source: NISER Survey 1983/84.

Table 8 Sources of initial capital

Source	Amount generated (naira)	Percentage
Personal savings	2,846,900	52.28
Relatives	223,900	4.11
Friends	168,500	3.09
Money lenders	-	-
Others (*esusu*)	136,000	2.50
Foreigners	-	-
Co-operative societies	41,500	0.76
Commercial banks	1,719,000	31.57
Merchant banks	310,000	5.69
State government	-	-
Local government	-	-
Total	5,445,800	100.00

Source: Researchers' Survey Findings, 1990

Table 9 Sources of additional capital

Source	Amount generated (naira)	Percentage
Friends	56,500	11.37
Relatives	32,500	7.14
Money lenders	182,000	36.62
Esusu	6,000	1.21
Commercial banks	132,000	26.56
Co-operative societies	85,000	17.10
Total	494,000	100.00

Source: Researchers' Survey Findings, 1990.

As Table 10 shows, there was a significant shift to money lenders, co-operative societies, friends and relatives for additional investment funds. There was also a decrease in the number of those who raised additional capital from the commercial banks and *esusu*. The reason for the shift from *esusu*, although not established from the responses, can be linked to the small-holdings of the *esusu* groups which might not have been in a position to support loans of this size. It might also not have been the turn of the intending borrower to be granted loans at the time the request was made. However, the shift from *esusu* is compensated by a shift to co-operative societies. Definitive proof of this would require further investigation.

Table 10 Sources of financing for initial and additional investments (%)

Source	Initial investment	Additional investment	Change
Personal savings	52.3	-	-
Relatives	4.0	7.1	3.1
Friends	3.1	11.4	8.3
Money lenders	-	36.6	36.6
Esusu	2.5	1.2	(1.3)
Foreigners	-	-	-
Co-operative societies	0.8	17.1	16.3
Commercial banks	31.6	26.6	(5.0)
Merchant banks	5.7	-	-
State government	-	-	-
Local government	-	-	-
Total	100.0	100.0	

Source: Researchers' Survey Findings, 1990.

The findings show that no personal savings were involved in the additional funding. Thus is understandable as the owners might have exhausted their personal savings in providing the initial capital investment. Whether they made profits or not requires further investigation. Using all of one's resources in starting a business is a bad financial management strategy. A reasonable mix between the use of one's personal savings and borrowed funds should be maintained at all times.

Relationship between the formal and informal institutions

Tables 8, 9 and 10 reflect a relationship of complementarity between the formal and informal markets. Where the SMEs had no more personal funds for additional investment, they turned to a large extent to the co-operative societies, a quasi-formal institution.

Although no funds for additional investment were sought from the merchant banks, there was still a substantial amount obtained from the commercial banks. The ability of the formal financial institutions, such as banks, to provide credit to both SMEs and large enterprises, and the ability of the informal financial institutions to cater to the predominantly small-medium enterprises, establishes their legitimacy to operate in a complementary fashion.

Since the deregulation of the financial system through SAP (in 1986) there has been much competition, particularly among the formal financial institutions and between them and the non-financial institutions. For example, some of the banks now operate small offices at marketplaces just to collect deposits from the traders and market women.

The People's Bank

Difficulties encountered by small-scale enterprises in obtaining credit must have influenced the government's decision to establish the People's Bank in Nigeria. The People's Bank seems designed to provide credit facilities to small-scale enterprises which find it difficult to approach the formal financial institutions and are scared away from the informal ones by the high cost of borrowing. The People's Bank is a formal financial institution which borrows from the informal institutions some of those attributes that have facilitated their operations: low transactions costs, prompt disbursement of loans, minimal paperwork, no collateral, etc.

The objectives of the People's Bank are:

- to extend banking facilities to the poor who, lacking collateral, do not have access to the credit facilities available from the formal financial institutions;
- to help cushion some of the painful side-effects of SAP on the poor sectors of the economy;
- to complement government's efforts at improving the productive base of the economy and raise rural employment and income;

- to inculcate the banking habit especially among the rural poor;

- to halt rural-urban migration.

The loan scheme is targeted towards the poor, and covers all kinds of business activities, including petty traders, artisans, market women, plumbers, food sellers, farmers, housewives, cattle rearers, hair dressers, tailors, barbers, and groundnut sellers.

Before August 1990, the maximum loan amount was fixed at 2,000 naira with a 50 naira minimum. An interest rate (service/commission charges) of 5 per cent was charged. Since August 1990, the maximum loan amount has been raised to 5,000 naira and the interest rate raised to 15 per cent. Loan repayment is spread over one year, with a two-week grace period. No "collateral", e.g. pledging of property, is required of applicants.

Instead, people applying for a loan with the People's Bank must form groups of between 7 and 15 like-minded persons. They must all be engaged in some kind of definable business activity, which must be inspected and approved. The secretary and chairman of each group receive their loan last, after other members have paid back their loans. This serves as an alternative to collateral *per se*. It takes about 2-3 weeks to apply for and obtain a loan from this source.

Table 11 reflects the extent of the operation of the People's Bank loan scheme to date in Lagos and Oyo States. Data from Lagos State, where the gender of applicants was known, show that more women than men received loans. This can be interpreted to mean that more women are involved in the type of business (petty trading) on which the scheme focuses. Since it was not possible to obtain a breakdown of the types of business activities, further investigation would be required to confirm this.

The number of applications and beneficiaries in both states shows wide public awareness of the scheme and a substantial amount of loan funds already disbursed. There is also significant unsatisfied demand, as reflected by the difference between the number who applied for a loan in Lagos State and the number who eventually received one. This situation could be attributed to factors including the inability of applicants to meet the loan conditions or the insufficiency of available loanable funds.

The default rate, which in this case represents those who have failed to pay on the due date, is quite low. In Oyo State, where data were available, only 88 borrowers (86 farmers and 2 traders) representing only 2 per cent of total beneficiaries were unable to pay on the due date. The farmers were waiting to harvest their crops, while the traders wanted to pay *en bloc*.

Table 11 Applications and loan disbursements by the People's Bank in Lagos and Oyo states

Lagos State

Local government area	Applications received (no.)			Disbursement (naira)			Total disbursed
	Male	Female	Total	Male	Female	Total	
Maroko	618	2,228	2,886	384	692	1,076	138,000
Agege	528	1,488	2,016	547	984	1,581	995,000
Ajegunle	452	706	1,358	265	510	775	671,000
Epe	482	453	935	296	326	622	212,000
Ikorodu	475	417	892	296	315	611	202,000
Badagry	474	319	793	208	280	488	97,000
Muslim	542	1,464	2,006	388	510	898	995,000
Total	3,571	7,135	10,886	2,384	3,617	6,101	2,410,000

cont ...

Table 11 cont ..

Oyo State		
Local government area	Beneficiaries (no.)	Disbursement (naira)
Ibadan	2,776	2,070,690
Otu	1,015	523,750
Ada	325	225,450
Osu	290	199,050
Total	4,396	3,018,940

Source: extracted from records of the People's Bank headquarters in Lagos and Ibadan

The People's Bank scheme appears to be by far the most innovative of all government schemes introduced so far to redress the imbalance caused by past government policies which discriminated against small-scale enterprises in Nigeria. The strength of this scheme lies in its simplified operations coupled with the promptness in loan procurement, both of which generally characterize the operations of the informal financial institutions. This is consistent with the suggestion by Box (1983) that the characteristics of the informal financial market or its structures could be used to develop small-scale enterprises in Nigeria.

The experience so far with the operation of the People's Bank — with collateral de-emphasized, low transaction costs and promptness of attention, and very little bad debt experience (guaranteed through in-built mechanisms of the system) — makes a strong case for adoption of more informal credit market structures for SMEs in Nigeria. There is, however, a caveat. With the increased interest rate (from 5 to 15 per cent), and considering the type of business activities undertaken by many borrowers from this scheme, one wonders whether they can cover the cost of capital and in the end break even. Is it possible to adopt the informal credit market structures for SMEs in Nigeria or elsewhere? Does experience indicate that informal financial institutions should continue to exist as a separate and recognized sector, or to operate side-by-side with formal financial institutions?

V Summary and conclusions

The results of this study show that much initial financing for SMEs came from personal savings of the operators themselves and from formal financial institutions, while additional financing came mainly from informal sources. This demonstrates that, as they develop, SMEs are financed increasingly by the informal financial institutions. It also shows a complementary relationship between the formal and informal financial institutions, with both providing resources to SMEs.

In principle, Nigerian small-scale enterprises can be said to make a valuable contribution to the economy, although this study has not addressed the specifics of that contribution. However, this study has shown that, by their nature, these enterprises have insufficient access to formal financial institutions, and as a result, rely more and more on their own or friends' and relatives' savings, and on informal financial institutions for investment capital. Thus, government policies aimed at the creation of a favourable environment for informal institutions are necessary to ensure their survival.

It has been shown that some existing government policies may be detrimental to the SMEs' development, whereas some have been designed to encourage them. Of those examined in this study, many of the enterprises that failed were operated by sole proprietors with minimal educational background or business experience. These enterprises often relied heavily on imported components, and were in many cases unaware of existing government incentives from which they could benefit. While on the one hand the respondents identified government policies as being responsible for their difficulties, on the other hand the respondents were unaware of the various incentives and credit facilities provided by the government. For example, about 75 per cent of the respondents were unaware of the "Work-For-Yourself" programme; 70 per cent were unaware of the National Economic Reconstruction Fund Programme; 81 per cent were unaware of the Small-to-Medium-Scale Enterprises Loan Scheme; and 79 per cent were unaware of the Small-Scale Industries Credit Scheme. To improve their chances of success, the government could do more to publicize the existence of these programmes which target SMEs.

The extent to which the level of education affected performance of the operators could not be determined clearly from the study. Although 88 per cent of the operators of those enterprises that failed had secondary education, about 49 per cent of the operators of the enterprises that did not fail had only primary education. Other than avoiding failure, the extent to which those enterprises run by the primary education graduates performed could not be determined. Primary and secondary schools in Nigeria, until recently, did not expose their students to management and business-related courses. Further research would be useful on whether such people with no business or management education can succeed as managers.

Nonetheless, the authors are of the opinion that a low level of education with no complementary training and experience can negatively affect business operations in several ways:

- The operators, particularly those with only primary education, may not know the sources of credit available to them in the market (see Table 5).

- Their ability to prepare bankable projects may be adversely affected as many of the operators do not want to utilize the services of outside consultants. This was confirmed when they were asked whether they prepare feasibility reports before embarking on their projects.

- These operators are not likely to be familiar with the various incentives which they could utilize to improve the effectiveness of their businesses (Table 5).

- These operators are unlikely to meet the more stringent application requirements of the formal financial institutions, and their financing options may be limited to informal institutions.

The introduction of the People's Bank, its unique operational modalities, and its apparently effective performance so far seem to confirm the argument that financial institutions adopting the positive features of informal financial institutions can contribute a lot more than the formal financial institutions in financing small-scale enterprise in Nigeria. For example, if small enterprises actually comprise the majority of those now patronizing the People's Bank, it could be argued that such enterprises tend to rely more on informal than on formal financial institutions, especially due to their lack of start-up capital or collateral.

The reliability and relevance of all of this study's findings are limited by the lack of a clear definition of Nigerian small-scale enterprise and of a realistic differentiation between small-scale and medium-scale enterprises. Grouping the two together tends to bury the real problems of each group and of the sector as a whole. Based on the authors' intimate knowledge of the environment, the findings of this study probably relate more to the medium-scale than to small-scale enterprises. However, more research needs to be undertaken to clarify these issues.

Notes

1. *Esusu* is a name given by the Yorubas of Nigeria to a particular type of informal credit institution organized and operated mainly by farmers, petty traders, craftspeople, social clubs, teachers, civil servants, etc. It is a major and popular form of informal financial institution which is identified across Africa. It is also called *susu, adashi, sanduk, tontines* and *hangbad* in Ghana, Chad, Sudan, Cameroon and Somalia, respectively.

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